Platform Cooperativism Consortium

INSTITUTE FOR THE COOPERATIVE DIGITAL ECONOMY

REDEFINING THE CONCEPT OF AN "ETHICAL BUSINESS"

A Report by

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About the Institute for Digital Cooperative Economy (ICDE)

The Institute for the Cooperative Digital Economy is dedicated to studying the cooperative digital economy.

Where, when, and how work is done is changing. Advances in artificial intelligence, automation, and data processing continue to shift responsibilities from workers to digital systems. These disruptions are often unpredictable and still unfolding.

To navigate these challenges, we need research that imagines, builds, and explores new visions of a fairer future of work. One starting point is the platform co-op model, which carries the cooperative principles into the digital economy. Platform cooperativism addresses the root causes of systemic inequality and presents a near-term solution for the problems plaguing our economy and democracy.

The cooperative digital economy is an under-researched area in the fields of anthropology, political science, sociology, history, and economics. This emerging field is closely linked with labor studies and cooperative studies. In business schools, this field of study is situated in the areas of finance, entrepreneurship, and organizational studies. In law schools, the pertinent areas are governance and corporate structure.

Acknowledging these research gaps, it is the purpose of the Institute to provide prospective and existing platform co-ops with applied and theoretical knowledge, education, and policy analysis. We are committed to realizing new visions for a fairer future of work grounded in relevant research, driven by imaginative proposals. Initial research questions focus on distributed governance, scaling, marketing, and start-up funding. The ICDE makes this knowledge accessible to diverse audiences in innovative formats.

Through this research, the Institute builds a body of knowledge that advances platform ownership and democratic governance for workers and Internet users alike.

Learn more at: https://platform.coop/who-we-are/icde/

This report was cooperatively designed by Keir M-Barnett and Co-operative News

INTRODUCTION

Redefining the concept of an "ethical business": A roadmap for unlocking access to socially responsible investment funding for worker cooperatives

Cooperatives have long existed as a more equitable alternative to corporations. Cooperative grocery stores, which tend to have strong links to local farms and supply chains—often themselves cooperatives—stand in stark contrast to the monolithic sourcing practices of national supermarket chains; electricity and internet have been made available to rural areas through locally operated cooperatives in areas where corporations refused; workers in industries historically rife with mistreatment, exploitation and low wages, such as domestic work or construction, are effusive about the experience of working in cooperatively run businesses in those industries.[1]

In particular, worker cooperatives, which are premised on their member-workers being collective owners, and therefore having democratic control over their workplace and sharing in the profits of the business, are inherently a more just and worker-centric structure than corporations, which are premised on extracting profits generated by a workforce to a shareholding ownership class.[2] While cooperatives are themselves no silver bullet, and can be at risk of replicating some of the same problematic practices as corporations–from replicating existing power imbalances by discriminating within their hiring practices, to failing to adequately reduce their carbon footprint–their basic structures offers enormous potential for mitigating the economic and social inequities now bound up in corporate activity.[3] The sharing of profits amongst workers makes them a powerful tool for addressing economic inequality; the accountability of their internal governance structures, which mean that worker-members ultimately govern and rule cooperatives, also means that labor abuses, such as wage theft or forced overtime, are less likely to occur.[4]

Yet, it is conventional corporations that have been receiving the nearly 31 trillion US *dollars* of "ethical finance", while worker cooperatives have often struggled to attract even small-scale loans from traditional forms of finance. It is these contradictions that this paper explores, arguing that it is time to debunk the myth of the ethical corporation, and to reframe business ethics and equitability. An "ethical company" ought to be one that shares its profits and power with its workers and the communities that it impacts. Ethical finance ought to mean investing in businesses that enable workers to profit from the labor and have a voice in the conditions of their work; it ought to mean investing in worker cooperatives. To do so, would also help overcome the barriers to growth and formation that many worker cooperatives struggle with: the lack of access to capital.

Importantly, such ethical investing ought to be done in a manner that respects the fundamental principles of cooperatives. As this paper highlights, in their need to access capital, some cooperatives are turning to funding options that risk undermining the fundamental member-ownership and control principles of cooperativism, by providing investors some degree of decision-making power in return for more capital. While not prescribing to a rigid purity test for financing cooperatives, the paper argues at the very least against relinquishing governance rights unless absolutely necessary and for being careful to minimize the potential for harm when doing so. Instead of escaping the capital conundrum by embracing financing that undermines a key tenet of the cooperative—its refusal to privilege capital over labor—the author sketches a roadmap for how cooperatives, and their advocates and allies, can change the norms of “ethical financing”. This would unlock not just more funding for cooperatives, but a more equitable economy and society.

Part one of the paper briefly outlines the fundamental principles and benefits of worker cooperatives. The second part explores the existing funding sources available to cooperatives that are consistent with the underlying principles of cooperativism, as well as the rise of experimentation with new types of capital-raising, and the limitations of all these existing sources. It outlines the benefits of obtaining debt-funding, while recognizing the limited amount of such funding that is available. The paper then turns to proposing a new strategy: promoting cooperatives as the only ethical optional for self-identified socially-responsible investors.

Throughout, the paper particularly focuses on cooperatives with worker-members that are operating in the technology sector, which are part of the universe of “platform cooperatives”[5], and in particular in the United States. As a sector known for its experimentation and willingness to reject traditional business conventions, as well as significance and growth of the industry globally, the technology industry represents a strategically important sector for cooperativism to gain traction. Those cooperatives that have been launched in tech sector are often competing against large Silicon Valley firms, and are operating in an industry that receives more seed-level investment than any other. Venture capital provides aggressive levels of funding to technology companies —with over 130 billion US *dollars* having been invested in small start-ups in 2018 alone—that enable recipients to rapidly scale or operate below-cost to eradicate their competition.[6] This makes their capital conundrum particularly pronounced. However, while focused on the tech sector, the ideas in this paper can be applied to the worker cooperative field more broadly.

Finally, the fact that this paper looks solely at the ways in which private actors in finance—or some of them—might be targeted to provide more capital to cooperatives, is not meant to suggest that policy interventions, such as preferential tax treatment or government-supported funding, are not warranted. To the contrary, they are desperately

needed. Building a cooperative economy will require a range of strategies—none of which should be seen as mutually exclusive—and ideally the efforts proposed in this paper to influence private actors would be supplemented by related policy and legislative reforms to incentivize cooperative growth and stem corporate power.

PART ONE:

THE PRINCIPLES AND BENEFITS OF WORKER COOPERATIVES

Part One: The Principles and Benefits of Worker Cooperatives

This paper is focused on the landscape of funding available in the US to cooperatives that have workers as members. These may be cooperatives that only have workers as their members and owners, or cooperatives that are owned and governed by multiple stakeholders, including workers ("multi-stakeholder cooperatives"). In the technology sector, these other stakeholders might be users—often customers—or the local community or communities where the company is headquartered or operates. Increasingly, as explored further in Part 3, investors are also being considered "members" in multi-stakeholder cooperatives, alongside workers and others.

There is a growing body of research to support the broad-based benefits of profit-sharing with workers. For example, a large study into employee-ownership schemes in the US (which include cooperatives, but also include other models such as employee-stock ownership plans, knowns as ESOPs), found:

- A 92 percent higher median household net wealth than those in conventional employment;
- 33 percent higher median income from wages;
- access to a greater array of benefits, including retirement plans, childcare, flexible work schedules, parental leave, professional development.

However, worker cooperatives are not simply about sharing profits. While likely rudimentary knowledge to most readers, worker cooperatives are generally understood as reflecting and advancing seven principles:

1. Voluntary and Open Membership
2. Democratic Member Control
3. Member Economic Participation
4. Autonomy and Independence

5. Education, Training, and Information

6. Cooperation among Cooperatives

7. Concern for Community[7]

These seven principles, when implemented meaningfully, result in an inherently more just working conditions for workers and members, as well as economic benefits. The accountability of their internal governance structures, which mean that worker-members ultimately govern and rule cooperatives—whether through simple passive board elections or more hands-on active governance—inherently reduces the risk of labor abuses that can exist in employer-employee relationships, such as wage theft or forced overtime, while aligning incentives to ensure workers have access to healthcare, adequate safety training and a healthy work environment.[8] As noted by the Democracy at Work Institute, which is dedicated to researching worker cooperatives, "[j]obs at worker cooperatives tend to be longer-term, offer extensive skills training, and provide better wages than similar jobs in conventional companies".[9] In addition, it is thought that because of the nature of worker-ownership, money may stay more locally grounded, rather than being extracted to communities where investors are based, thus building community wealth.[10]

This is not to suggest that worker cooperatives solve all inequities or evils, or themselves cannot be problematic. More research is needed, in particular, into whether and how cooperatives impact non-members, such as their suppliers, non-member workers or local communities, as well as in examining whether or how cooperatives engage in discriminatory practices. Similarly, there is a dearth of research into whether there are any differences in the environmental practices of cooperatives and non-cooperatives operating in similarly-situated contexts. Put another way, the structures of cooperatives have clear benefits for their members within them, but they need not necessarily address the worst forms of profit-seeking or harmful practices to those outside of them. However, despite these gaps in research, there is considerable anecdotal and empirical evidence that cooperatives provide more sustainable, resilient and equitable outcomes than corporations.[11]

Central to securing funding for cooperatives, therefore, is securing funding in such a way that the core principles of cooperativism are preserved. Any finance arrangement that risks undermining one of the seven principles of cooperativism, threatens whether an entity will be able to achieve the key benefits associated with cooperativism, such as workplace democracy and agency, which in turns threatens the associated benefits of worker-cooperatives.

PART TWO:

THE CHALLENGE —THE LIMITATIONS OF EXISTING FUNDING SOURCES FOR COOPERATIVES

Part Two: The Challenge—The Limitations of Existing Funding Sources for Cooperatives

Unlike a conventional company, which can access a pool of well-capitalized professional investors—such as private equity funds, family offices, pension funds, high net worth individuals—a traditional cooperative has significant constraints on the types of funding it has available to it, if it wishes to retain its key values of member ownership and control. As a result, the ability of cooperatives to challenge and displace the dominant, and highly extractive, corporate form, has been impaired by their ability to grow and scale, both vertically and horizontally.

This section explores the sources of funds available to cooperatives, as well as well as the specific considerations and limitations as they apply to cooperatives seeking to retain their core values and principles as outlined in Part One. These funding sources, broadly classified, are:

1. Member-funding (e.g. contributions from workers or members);
2. Debt funding (e.g. loans from banks);
3. Retention of profits (i.e. accumulating earnings); and
4. Emerging forms of equity funding that are structured to minimize the risk that they undermine the ownership and control principles of cooperatives.

It is worth noting that new ideas are emerging in this space rapidly. For example, the “E2C” model encourages start-up founders to “exit” to community, instead of traditional forms of capital.[12] This approach avoids the problems of start-up capital and growth for cooperatives, by encouraging conventional companies (with their ease of attracting initial investment) to later sell to their workers and users. Similarly, there has a been an explosion of private equity-styled conversion funds, such as the Fund for Employee Ownership and the Legacy Business Fund, whose function is to enable workers to buy out their existing owners and covert into cooperatives or employee-owned businesses.[13] In addition, bold new funders and funding platforms—from the start.coop accelerator to then soon-to-launch Co-op Exchange (designed to mimic a standard stock exchange)[14] to the call for a capital fund for platform co-ops premised on the community shares model[15]—are on the rise. With these new approaches, come an evolution of new ideas

and models for financing itself. Most of these ideas are captured and covered by the general classifications and analysis below, although it is possible new models will emerge that raise different considerations.

1. Member Funding

Historically, the individuals or organizations who comprise the members of a co-op have typically provided the initial source of capital for cooperatives.[16] Indeed, often a condition of co-op membership is providing some type of contribution. This could be payment of a membership fee, providing a particular type of service (e.g., a certain amount of time or output produced, in the case of worker-members); or purchasing one share of voting common stock. These contributions either become part of the member equity capital in the co-op if they are financial/capital, or are considered part of the wider patronage if received in the form of service or labor.

In addition to this baseline type of membership equity, some co-ops either encourage or allow additional capital to be invested in addition to the membership fee in the form of additional non-voting preferred stock, or non-voting common stock.[17] This modality of investment has been favored in co-ops because it keeps the threshold for membership low, while permitting members with adequate financial means to provide the co-op with additional funding, thus further the principles of equitability and fairness central to co-ops. The method for determining the actual return or dividend provided to each member varies from co-op to co-op, although the basic premise is to divide a member's individual patronage or input level by the aggregate total patronage or inputs provided by members.

Worked example:

- All members receive one share (and one vote), upon paying the membership fee. In addition, members may also contribute a further 1,000 dollars in return for non-voting common stock; these do not have any further voting or governance rights, but mean contributors are entitled to a greater proportion of profits. All members have equal and full voting rights, normally with the ability to run for the board and/or other representative governing bodies. The shares are redeemable for full value when the member exits (plus any declared but unpaid patronage dividends).

Limitations and Considerations

The primary limitation of membership funding is that it provides access only to a very limited and narrow scope of capital, that is constrained by the financial resources of the members of the co-op. Alone, it is generally insufficient for co-ops during start-up and growth phases.

There have been efforts to enable co-ops to attract investment from the public, such as a crowd-sourcing or community-share models, which sometimes use the term “membership”. Through these investment models, any person who invests might become a “member” (and potentially receive some type of voting rights). However, by comparison, in membership-funding, as traditionally used in co-ops, investing is not open to the public. Rather, it is limited to those who are, because of their work or patronage of the co-op’s goods or services, considered members under the co-op’s bylaws (and who therefore have voting rights). Thus, the wider community fundraising models are better classified as innovative forms of “equity” fundraising, and are examined in the final part of this section.

Any efforts to incentivize or attract more finance by allowing voting to be weighted, based on the amount contributed (e.g. such that bigger investors are rewarded with greater voting rights), significantly undermines the fundamentally democratic nature and principles of cooperativism. If adopted, entities might still have some governance practices that make them more equitable than corporations, such as giving all workers or members some voting power. This makes them more equitable than traditional corporations, but they are no longer cooperatives and ought not to hold themselves out as such.

2. Debt Funding

As debt does not demand voting or ownership rights, it does not interfere with the fundamental principles of cooperativism. As a result, access to debt—that is, loans—has long been critical to the growth and success of cooperatives.

Limitations and Considerations

Traditional banks and the financial industry have largely ignored or avoided lending to co-ops. There are a variety of reasons for this, most of which are based on concerns

that, when analyzed, have little to do with whether objective evidence about whether cooperatives would repay such their loans. The reasons articulated to this author during the Fellowship period by private and traditional financers and bankers included:

(i) **Misperceptions:** this is part of a wider misconception of co-ops as small, unsophisticated organizations, contributing to a perception that they therefore involve more operational and credit risk than companies. Traditional finance providers often raise particular concerns about the governance of co-ops and their ability to adequately respond to dynamic and time-sensitive issues, or to make sufficiently savvy business decisions. The particular concerns that were raised during conversations with this author over the course of the Fellowship include:

a. That worker co-ops are often associated with consensus decision-making by members (i.e. unanimous member consent is required for all strategic decisions), which is viewed as an inefficient method for a business of meaningful scale or complexity;

b. In a company, strategic business decisions (opening or closing product lines, capital expenditure decisions, acquiring other businesses, financing decisions etc) are made by a board appointed by and answerable to shareholders (often, professional investors) who are likely to be experienced with such matters in order to have been selected as board members. Co-op members, such as workers or users, were perceived as having experience in the business' day-to-day operations, but not has necessarily having experience in making strategic business decisions; and

c. Because workers and members have different interests than the narrow profit-maximization goals of shareholders, a co-op's decisions may prioritize members' welfare interests over the long term viability of the business. For example, they may raise wages to a level that minimizes profit or makes it difficult to ensure debt is serviced.

(ii) **Lack of familiarity with co-ops:** which are not covered in any depth in mainstream business and law school curriculum, nor are they featured regularly in industry publications/media. As a result, lenders are often unfamiliar with their operations. This uncertainty can push traditional lenders to decline or reject applications.

(iii) **Limited access to capital makes co-ops risky:** the lack of access to traditional sources of equity (from professional investors), as discussed

further below, makes co-ops less able to deal with temporary liquidity issues, which makes them seen as more risky and less attractive investments; and

(iv) **Limited interest in growth because of profit limitations:** that the core clients of traditional financial institutions are the professional investor class, who have no interest in co-ops, because they cannot own them or because of concerns that they will not seek to maximize profit in the same way that conventional companies will. As a result, there is little motivation or pressure on the part of traditional finance institutions to support or form debt-based relationships with worker cooperatives.

As a result of this hesitance—however unfounded it may be—cooperatives have generally instead to turned either to credit unions or community development financial institutions (CDFIs) in order to access loans. CDFIs are private financial institutions that are dedicated to delivering responsible, affordable lending to help low-income, low-wealth, and other disadvantaged people and communities join the economic mainstream; like credit unions, their background and mandate often means they will support worker cooperatives because of mission- and impact- alignment. Yet for worker cooperatives in particular, as opposed to producer, consumer or housing cooperatives, even these sources are very limited: within the US, there are approximately 800 CDFIs, yet only six offer dedicated funding for worker cooperatives at a national or regional basis.[18]

Based on the publicly available financial statements and annual reports released by these cooperative-friendly lenders, the amount invested in cooperatives in the US is approximately 350 million US *dollars*.[19] However, the vast majority of this money is allocated either to non-worker cooperatives, such as food cooperatives or housing cooperatives. Worker co-ops or multi-stakeholder co-ops with worker-members make up a small proportion of funding. For example, the Cooperative Fund of New England, which is nationally recognized for its long-term support of worker cooperatives, has a portfolio of approximately 26 million US *dollars*, of which approximately 31 percent are invested in worker or other non-housing or non-food cooperatives.[20] The majority of the six CDFIs have less than 5 million US *dollars* each specifically invested in worker cooperatives. While it is of course possible that these allocations, and the number of credit unions or CDFIs who provide loans to worker cooperatives, will increase in the face of increased demand, the snapshot shows how little funding is available even within financial communities specifically geared towards supporting cooperatives.

Unfortunately, as experienced by several cooperative founders, existing cooperative-friendly loan funds can be hesitant to fund start-up co-ops. This is for the reasons l isted above, as well as the greater risk of failure associated with the creation of new s mall businesses.

3. Retention of Profits/Earnings

This can be an important source of capital for established cooperatives. For example, Equal Exchange, one of the largest worker cooperative in the US by revenue, has since 1989 had worker-owners reinvest 60 percent of net profits.[21] This has resulted in over 5 US *dollars* million in retained earnings, which represent the cumulative profits that workers have reinvested annually since the entity first turned a profit.

Limitations and Considerations

For start-up co-ops, or those operating with slim profit margins, this is not a viable source of growth. Given, also the short-termism and growth-obsession of corporate America and capitalism, surviving only on profits will significantly limit scale and long-term feasibility during down-turns or if facing aggressive competitor behavior.

4. Innovative Forms of "Equity" Funding That Do Not Undermine Ownership and Control Principles

Given the limitations of the traditional sources of funding--debt, member funding and profit retention— there has been an increasing trend towards cooperatives seeking "equity" funding. This is particularly true amongst new cooperatives that are emerging in the technology sector. For example, Savvy Cooperative issued a press release announcing it recently raised an undisclosed amount of seed funding from Indie.VC in what is thought to be "the first-ever venture capital investment in a cooperatively-owned business."[22] While the reasons for platform co-ops engaging more actively in equity-style financing were not researched, it is possible this is because they are operating and competing within a culture where the attraction of venture capital is, in itself, seen as a metric of success, and because significant funding is often needed to compete against dominant large competitors in the same market. It also appears to be somewhat generational as younger entrepreneurs are drawn to the equitability of the cooperative model but are more open to experimenting with the form itself.

These "equity" investments can be categorized into two types: (1) External non-member investment without voting rights; (2) Investor-member equity, which includes voting rotes. The latter has a risk of eroding the key principles of cooperativism by providing control and ownership to investors, rather than limiting these to patron members.
Both models are explored further below.

a. External non-member investment without voting rights.

Cooperatives may issue non-voting preferred stock to external investors. As it is non-voting stock, this investment form does not fundamentally undermine the principles of cooperativism. This avenue has become an increasingly desirable tool by cooperatives to raise additional capital. While there is still a financial return component, a primary motivation for investors often arises from mission-alignment, where supporting the cooperative business model and the mission to which the cooperative is committed is part of the goal and rationale for investment. It is generally not favored by the wider profit-oriented investment community, because of the risk it involves without also providing investors with control or power over the investment/company that they generally expect.

Mission-aligned investors may include impact investors, charitable foundations and high net-worth individuals looking to invest with a complementary philanthropic purpose, all of who invest with a relatively long-term perspective and support the mission and values of the cooperative. In general, the capital invested through such non- voting preferred stock is negotiated so that it is subordinate to the patronage capital of member-owners—that is, that it is secured and paid after worker-members are paid—however this can vary from deal-to-deal.

Four different examples of how these investments have been structured, none of which entail sharing governance or voting rights, are provided below.

1. **Profit-sharing:** Return is paid back to investors through an agreed proportion of profits. There is generally a cap on the initial amount of investment to avoid it becoming unduly excessive or extractive. Profit-sharing can structured as a fix amount of annual profits to be shared with the investors annually, or it can be negotiated such that dividends must be approved at the discretion of the board. However, adding this constraint, or any others, may increase the expectation or demands that investors are part of the governance of the entity. In addition, there can be non-dilutive constraints imposed.

    a. **Simple Worked Example:** 5000 US dollars per share, to be paid through board-approved annual dividends, but with an aggregate 4x capped return on the original investment and without any voting rights. This means that whenever 20000 US dollars have been paid to the investor through dividends, no further payments will be made. See appendix A for a more detailed example.

2. **Revenue-sharing:** Return is paid back to investors through a proportion of revenues. This approach can be more favorable than conventional interest-based loans, as it means that repayment scheme is limited to actual revenue from sales, which can sometimes be less crippling than early-stage debt servicing (especially if sales are not yet being made), whilst avoiding the risks to investors that profit-sharing entails. However, as the return is generally fixed at a set proportion of revenue (i.e. non-contingent), it can cut into the cashflow for co-ops with limited funds. There is generally a cap on the initial amount of investment, usually based on a multiple of the initial investment, to avoid it becoming unduly excessive or extractive. Once the cap is reached, the revenue sharing agreement ends, or the shares can "self-redeem."

    a. **Simple Worked Example:** 5000 US dollars per share, entitling the investor to 1% of gross revenue per annum, with total repayments capped at 2.5x the initial investment; no voting rights. This means after 12500 US dollar have been paid, no further payments will be made. See appendix B for a more detailed example.

3. **Target-dividend:** Return is paid back to investors through dividends, however these have a specific target rate. The investment is made through a form of preferred stock, often with particular rules associated such as a minimum period for which stocks have been held before they can be sold or transferred. They can have a cap, but need not. Those that have a cap ought to be seen as a modified form of debt funding; those without a cap—that generate indefinite returns at the target rate—are a hybrid form of equity funding.

    a. **Simple Worked Example:** 5000 US dollars per share, to be paid through board-approved annual dividends that have a target rate of 4% per annum, and without any voting rights. See appendix C for a more detailed example.

4. **Demand dividend:** Return is paid back to investors through periodic payments based on a percentage of free cash flow (usually under 50 percent), as available, up to an agreed upon multiple of the investment and within agreed parameters.[23] The fact that it has a limited upside, and that its payment is set based on agreed parameters, rather than because of the decision of the owner-investors, is what differentiates this from a regular dividend. Generally demand-dividends make payments only if specific profit levels are obtained; where the dividend is based on revenue levels it is better described as a "debt royalty structure". Payments are generally made after a "honeymoon period" that allows the capital to be deployed. Generally, a cash flow focused financial forecast is attached to a demand dividend term sheet, which outlines expected returns. This forecast, equal to the length of the debt term, ensures alignment of investor and investee expectations and reduces the potential for accounting irregularities due to associated covenants. As a result, however, demand dividends place

a premium on trust and transparency between the investor and co-op. They are not well-suited for co-ops that are far away from positive cash flow or with high product development or service model risk.

a. **Simple Worked Example:** Investors will be entitled to receive, prior to the payment of dividends to worker-members, 20 percent of the Free Cash Flow of the cooperative whenever it has a profitable year, until total dividends paid have reached a capped 3x return on the original investment. See appendix D for a more detailed example.

Other models exist, such as convertible notes[24] and certificates of deposit[25], however the above are the most frequently used methods from those spoken to in the US.

It is important to recognize that, when analyzed from a financial perspective, although all these types of investments are described as purchasing "shares" in a cooperative or are proposed to investors who might otherwise describe themselves as equity investors, as they neither provide any governance rights (e.g. voting rights), and because they often include capped upsides (e.g. limits to the maximum returns), they technically are not equity investments, but rather innovative forms of debt-financing or contracts.

b. Outside investor-member equity with voting rights.

A hybrid cooperative model that permits the issuance of voting stock to investor-members has recently been recognized in co-op law in the US, known as "Limited Cooperative Associations".[26] This occurs by creating multiple governance and ownership classes within a cooperative, including permitting ownership—and thus voting—rights to investors. This can be obtained through any of the four vehicles described above, with the difference that voting rights are attached.

Attracting voting investor-member equity capital can offer a key opportunity for cooperatives to achieve scale, however with it comes the inherent risk and undermining of the one-member, one-vote principles of cooperativism. There can be diverging interests between investors and workers. Care therefore needs to be taken before exploring this approach, including evaluating both the values of the investor(s) and their history in respect of governance and interference in cooperative or company decisions. In addition, the amount of power and control being shared with investors should be scrutinized, with a minimum step being to ensure at least 51 percent of votes remain with members. For example, the Equal Care Co-op ran a successful community shares offer in 2019 that netted £410,910 from 173 community investors.[27] They structured governance rights such that investor members have a total of 10% of the vote at AGMs, whereas workers—and the patients they support or their advocates—have a collective

90% of the vote.[28] This is very different from a venture capital deal where traditional finance investors are provided with veto power or significant decision-making rights. Similarly, a comprehensive model and system for considering how to fairly balance and incorporate investors in the governance and ownership of cooperatives, alongside workers, founders and users, has been developed by the FairShares Association.[29] Proponents of sharing ownership and governance with investors argue that it can potentially bring some positive benefits linked to the expertise and networks of investors, such as more robust decision-making and greater ongoing access to capital.

However, there is not yet sufficient experience or evidence into the effects and consequences of including investors in cooperative ownership and governance on the outcomes for workers, communities or cooperatives themselves. As a result, cooperatives should proceed with caution. Even ensuring there strong values alignment and minimal decision-making power with investor-members may not be enough to ensure the principles of worker-centricity are not corrupted, given that investors can often wield influence and power over decision-making.[30] For example, investors may make future funding arrangements contingent on support for particular positions, or they may have more subtle influence through their perceived expertise in respect of finance or business management. Much of the benefit of this expertise can be obtained through investors operating as advisors to a co-op board, rather than having voting power on it, and where possible such avenues ought to be explored and the loss of power and control minimized or avoided altogether.

PART THREE:

THE NEED TO CHALLENGE AND BREAK THE PREVAILING MINDSETS THAT ENABLE CORPORATIONS TO DOMINATE

Part Three: The Need to Challenge and Break the Prevailing Mindsets that Enable Corporations to Dominate

As the above analysis indicates, for cooperatives looking to grow, debt-funding is often the most preferable form of funding for cooperatives, as it preserves the ownership and control principles central to cooperativism. This debt financing can take the form of conventional loans, or the flexibility of non-voting forms of investment with fixed upside and returns that are sometimes referred to as “equity” investments or stock-purchase but in fact have the key characteristics of debt, as explored above.

However, despite the innovations around the forms of funding, a key problem remains: the limited funds available for these transactions. Central to the concerns identified above is that, despite the benefits of cooperatives, funds continue to be directed to the dominant business model in the market: the corporation. It’s near-total domination of the public and professional imagination of how business ought to be structured if they are to be viable—despite the wider societal economic, societal and environmental harms caused by this model, as explained further below—is a primary reason that cooperatives struggle to obtain funding. This cycle of myths and misperceptions that support the corporate form, and which undermine cooperatives, can be seen in Figure 1.

Absent policy interventions to incentivize public or private access to loans (which ought to be aggressively pursued, given the positive societal benefits of cooperatives, as explored further below), there are two primary methods that emerge to break this cycle:

a. **Business-case:** Demonstrate that cooperatives are viable business structures that warrant investment and ought to dominate the market.

b. **Societal-case:** Demonstrate that cooperatives are more equitable, ethical and preferable from a societal position, such that funds and policy interventions favor supporting cooperatives on this basis.

The strategies for each of these approaches are different. The former might entail strategic interventions at business schools, law schools and other professional spaces to push for curriculum changes that include teaching and learning about cooperatives. Too often, this author has heard business people say that they were never advised about cooperatives—or that their requests to ensure their business was fair and equitable did

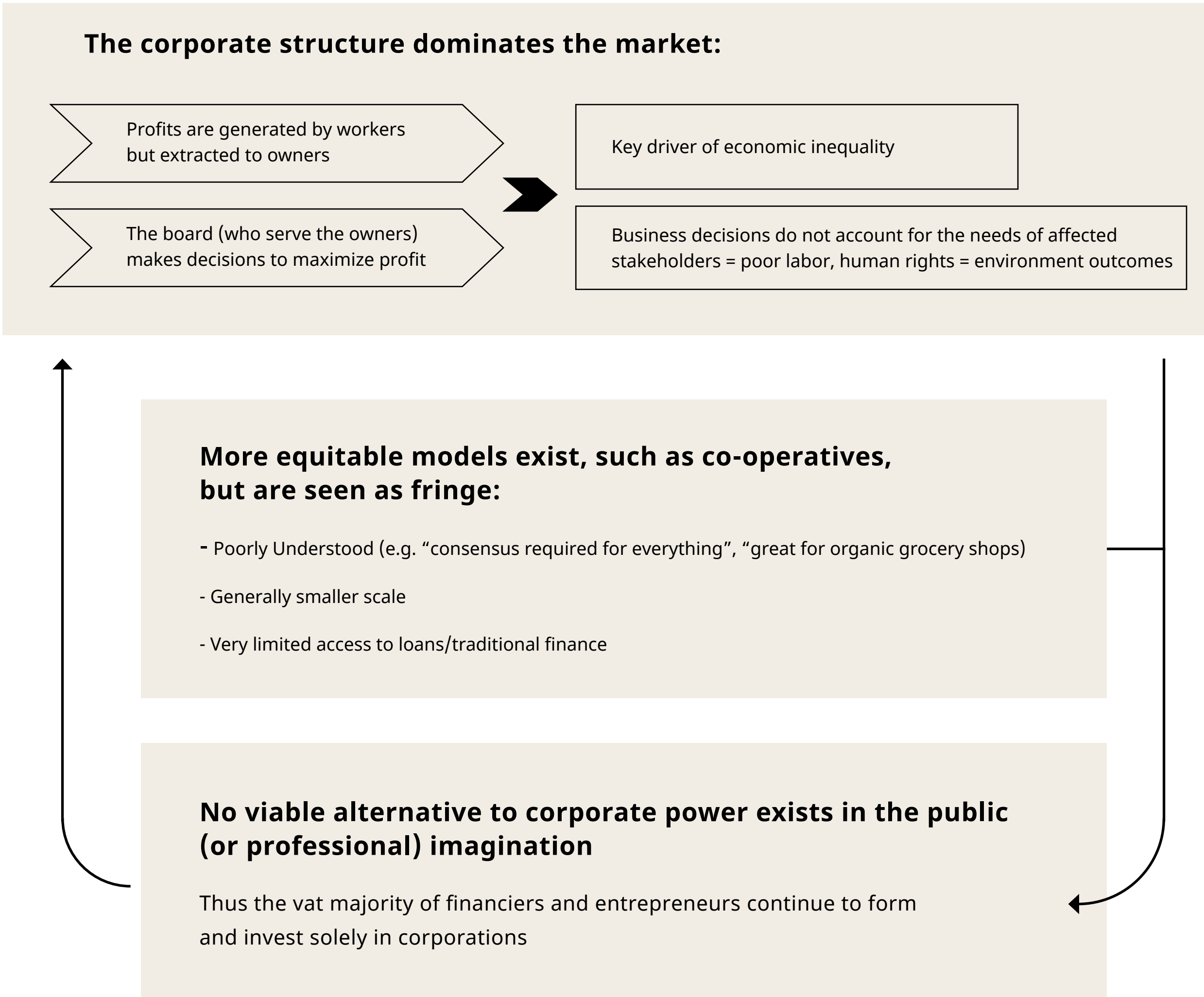


Figure 1:
Existing cycle of corporate domination

not result in any conversation about cooperative structures—in a way that has meant the corporate form dominates. Similarly, many of the inhibitors to investing in corporations by traditional finance could be addressed through education and awareness-raising. Such interventions could no doubt help.

Fundamentally, however, it is the market itself that confirms these suspicions: the lack of large-scale and thriving worker cooperatives, particularly in the technology sector, reinforces (inaccurately) the assumption that cooperatives are not viable. While there are certainly some successful large-scale cooperatives, such as Mondragon in Spain or UCLSS in India, these examples are not well-known outside of cooperative communities. As

long as the capitalist metrics of success prevail, such as looking narrowly to a business's market share, profits margins or levels, or returns on investment, then the business case for cooperatives will likely—and problematically—viewed in that light. Thus, horizontal scale and growth of cooperatives will be unlikely to shake existing, and cooperatives will be pressured to conform to excelling on the metrics of corporations. This is not only undesirable, given that many of the metrics are only achieved as a result of squeezing production costs in a way that is unsustainable and harmful, but likely difficult given the core values of many cooperatives.

This is not to say that the business case for cooperatives does not exist, but that demonstrating it requires changing from a short-termist and profit maximization mindset, to a long-termist mindset that values stability and sustainability alongside economic feasibility.

PART FOUR:

A NEW STRATEGY— PROMOTING COOPERATIVES AS THE ONLY ETHICAL OPTION FOR "SOCIALLY RESPONSIBLE" INVESTORS

Part Four: A New Strategy—Promoting Cooperatives as the Only Ethical Option for "Socially Responsible" Investors

Developing funding model(s) and organization that allow the growth of cooperatively-structured technology companies, as well as those in other industries, is paramount. A critical strategy to obtaining more money is to make the linkage between cooperatives, ethics and positive societal outcomes, such that the considerable amount of investment money allocated to socially responsible investment funds is redirected to cooperatives.

1. What is socially responsible investment funding and why is it flawed?

Socially responsible investing has multiple names and forms. At its heart, it is about deploying investment strategies that value or emphasize strategies that emphasize sustainable, responsible and positive societal outcomes. All told, socially responsible investing is estimated to now be worth 31 trillion US *dollars*.[31] The primary strategies include:

1) Exclusionary screening. This is where particularly harmful industries are "screened out" of a portfolio, such as tobacco, alcohol, weapons stocks or fossil fuels. This means all other assets or industries are permitted, regardless of the conduct of the particular company. In total, an estimated 19.8 trillion US dollars is held in exclusionary or negative screening investment strategies, covering a considerable number of publicly-traded companies globally.

2) ESG criteria. This is where investments are made based on their "Environmental", "Social" and "Governance" characteristics. The characteristics will vary from fund to fund. Common criteria include demanding that companies create and disclose climate change policies (environmental), have robust anti-discrimination policies (social), and have a diverse board and senior management (governance). Investors who integrate ESG criteria into their portfolios are estimated to hold up to 17.5 trillion US dollars in assets, covering both public and private companies.

3) Impact investing. This is where investors invest in companies that have demonstrably positive environmental and social impacts, on top of positive

financial returns. These are generally not publicly-traded companies. The Global Impact Investing Network released its latest survey of its 294 members who manage 404 billion US *dollars* dedicated to "impact", nearly ¾ of which is invested in the United States.[32] These investors report compound annual growth of about 17 per cent and estimates that if investors outside its network are included, the sector is worth upwards of 700 billion US *dollars*.[33]

However, many of these funds hold a significant number of investments in deeply problematic companies, making "socially responsible investing" a deceptive concept. To begin, as ESG and exclusionary investments are often made up of publicly-traded companies, they are inherently limited to those on the stock exchange—many of which engage in unsavory practices. Simply because a fund does not invest in tobacco companies, it does not mean that its investments in other companies are ethical. Similarly, simply because a company has strong environmental practices, it does not mean that it has sound human rights practices—yet the weightings systems of ESG funds allow for this. Thus, the most prominent funds, of both forms, hold investments in obviously problematic companies. For example, Parnassus Investments' most prominent fund, which has over 18 billion US *dollars* in fund assets, its two largest investments in Microsoft and Amazon, despite the fact that they have been accused of failing to respect privacy or adequately treat workers and major environmental harm, respectively.[34] Similarly, Vanguard FTSE Social Index Fund, which has almost 8 billion US *dollars* in fund assets, includes Microsoft, Apple and Amazon in its holdings.[35]

Most importantly, and in stark contrast to cooperatives, all of these funds invest in traditional corporations in which the ownership class is divorced from the labor or user classes. In this way, these companies are all perpetuating, rather than addressing, income inequality, as explained further below.

2. Why should co-ops receive ethical funding?

i) Traditional companies exacerbate economic inequality and are not structured to consider societal impacts

Companies are today run and controlled by a board of directors and executive management whose legal obligation is to return a profit to shareholders. However, over the last hundred years, economic power has concentrated such that shareholders in large corporations have evolved from being individual people to largely being institutional investment entities.[36] The small proportion of the population who own them or who sit on corporate boards do not directly experience the on-the-ground consequences of the company's decisions: they do not live near or work in the mine sites, farmland or factories where the repercussions reverberate. They do not see the human or environmental toll of squeezing margins and producing faster, cheaper, more.

This, combined with the fact that boards are legally prohibited from making decisions that prioritise community or societal interests above those of the shareholders, means that decision- makers in a corporation are neither structurally situated, nor motivated, to consider the impacts that their business operations have on local communities (let alone to value them).[37] In fact, they can be sued for taking social or environmental factors *into account*, if they come at the expense of profit. Instead, pressures and incentives are placed on companies to make whatever decisions will maximise shareholder profits without sharing those economic returns with those whose day's labour generates them. This has caused today's extreme economic inequality and increasing stratification of our ownership class.

While the human rights and environmental abuses of large corporations are well-known, such as consistent exposés of abuses in the supply chains of consumer goods and agriculture, or those associated with oil and gas, the wider association with technology companies and rights abuses has taken longer to form in the public consciousness. However, today it is tech companies that most consistently are under scrutiny in the US, for concerns about their failure to respect the right to privacy of internet citizens or for their efforts to ensure critical labor is performed by "gig workers" to whom they do not owe basic labor rights .[38]

ii) Cooperatives are structurally situated to respect labor rights and address economic inequality

By comparison, as explored in Part One, by definition cooperatives share their profits with the patrons whose labor and inputs generate them, rather than with passive capital or absentee investors. As a result, they inherently mitigate rather than exacerbate income inequality. Similarly, given that cooperatives are governed and controlled by their members, they are inherently designed to benefit, rather than exploit, their membership base. In the case of worker cooperatives, or multi-stakeholder cooperatives with workers in their governance, the likelihood of certain types of employer-employee abuse occurring, such as a wage theft, forced labor or forced overtime, is significantly reduced, if not eradicated.[39] More generally, they provide more empowered working conditions and, with it, greater benefits.

With the technology sector, for example, Uber and Lyft have been embroiled in significant well-known disputes regarding their mistreatment of independent contractors, such as denial of basic healthcare benefits and basic employment protections, as well as allegations of unfair pay scales and rates[40] and trying to shutter efforts by workers to organize.[41] By comparison, Eva[42], a Montreal-based cooperative that has driver members and rider members who have decision-making power. This has the following consequence:

Earlier this year, Uber cut driver wages by 25 percent in Los Angeles without warning, *sparking protests from drivers. On Eva, those types of changes don't occur unless voted on. Instead, they receive a guaranteed base wage of between 13 dollars and 15 dollars per hour in exchange for agreeing to work set hours in certain high-traffic areas. If the drivers make less in fares than their guaranteed wage, Eva pays them the difference. If they make more, the driver pockets everything.*[43]

Why are there not more apps-based taxi companies like Eva? Fundamentally because Uber, Lyft and other technology companies operate on a model where they scale as rapidly as feasible, made possible as a result of obtaining venture capital that can also be used to temporarily offer aggressive pricing—sometimes below cost—to eliminate smaller competitors. By comparison, smaller-sized platform cooperatives need to individually develop technology and apps to rival these global behemoths, despite the fact that they ordinarily emerge to serve just one geography or community, which is a cost-intensive endeavour, and yet they often have little access to funding.

3. How to debunk the myth of the ethical corporation and demand socially responsible investors support cooperatives?

If even just a small slice of socially responsible investment funds could be directed to cooperatives such as Eva, the amount of funding available to them would be immense. Indeed, if just one per cent of the estimated 31 trillion US dollars were to be redirected towards cooperatives, this would amount to 300 billion US dollars, which is almost a thousand times more funding than is currently available to cooperatives in the US.[44]

To do achieve this, a three-pronged strategy could be useful:

1) Debunk the myth of the ethical corporation and of socially responsible investing. First, the myth of the ethical corporation needs to be erased. Corporations are premised on extractive models where wealth is generated for an ownership class and means that individuals do not genuinely own their labor, but rather rent it, and that fundamentally the corporate structure has caused extreme economic inequality and led to the cementing of today's ownership class. Yet somehow, we've allowed such companies to co-opt the language of being "fair", "responsible", and "ethical" depending on how they source their supplies, whether their labor force is diverse or if they commit to utilizing renewable energy. While all of these represent relatively more equitable positions than that required by law of corporations, they risk overshadowing the central economic and power inequities perpetuated by corporations.

2) Reframe ethics and equitability.
The question of whether a business is equitable ought to be, first and foremost, determined by asking:[45]

- Whether the business is legally and operationally accountable to the workers, communities and other stakeholders who are affected by its decisions. That is, is it workers and communities who democratically govern the entity? Important questions underpin this, such as examining who is affected by a business, what is the demographic of the communities it serves and benefits from. Assessing this, particularly by examining the race, gender and socio-economic make up of relevant communities, will further help reveal whether business is appropriately governed by relevant constituencies; and

- Whether the company shares its ownership and benefits with the people who create corporate value or who absorb the impacts of corporate behavior, such as workers and local communities. That is, do workers and relevant communities own the entity? Are they a central beneficiary of its operations?

These two central criteria ought to then inform and infuse the criteria used by "socially responsible" investment firms and funds (see below).

3) Promote successful examples of cooperatives.
In order to challenge public consciousness, there also needs to be a promotion of those cooperatives who are successful. Learning lessons about failures is also important. Both are explored further below.

Some lessons can be learned from the advocacy campaigns used to influence investment communities to-date, such as the efforts to pressure institutional investors to divest from fossil fuels, as well as the more generally campaigns against large corporations who commit environmental or human rights abuses.[46] Applying some of those lessons to this context, a potential roadmap might be:

- Targeted advocacy of impact investment funds. Beginning first with the most progressive and radical of impact investors, perhaps through a pledge or commitment by investors to hold a proportion of their assets in worker cooperatives. For small impact investment funds, this might be directly investing in cooperatives; for larger funds it could be investing in cooperative loans or conversion funds. After initial signatories have been found, these can be leveraged within the impact investment community with some successful internal and external advocacy campaigns, beginning first with engagement and persuasion, before potentially moving to more aggressive naming-and-

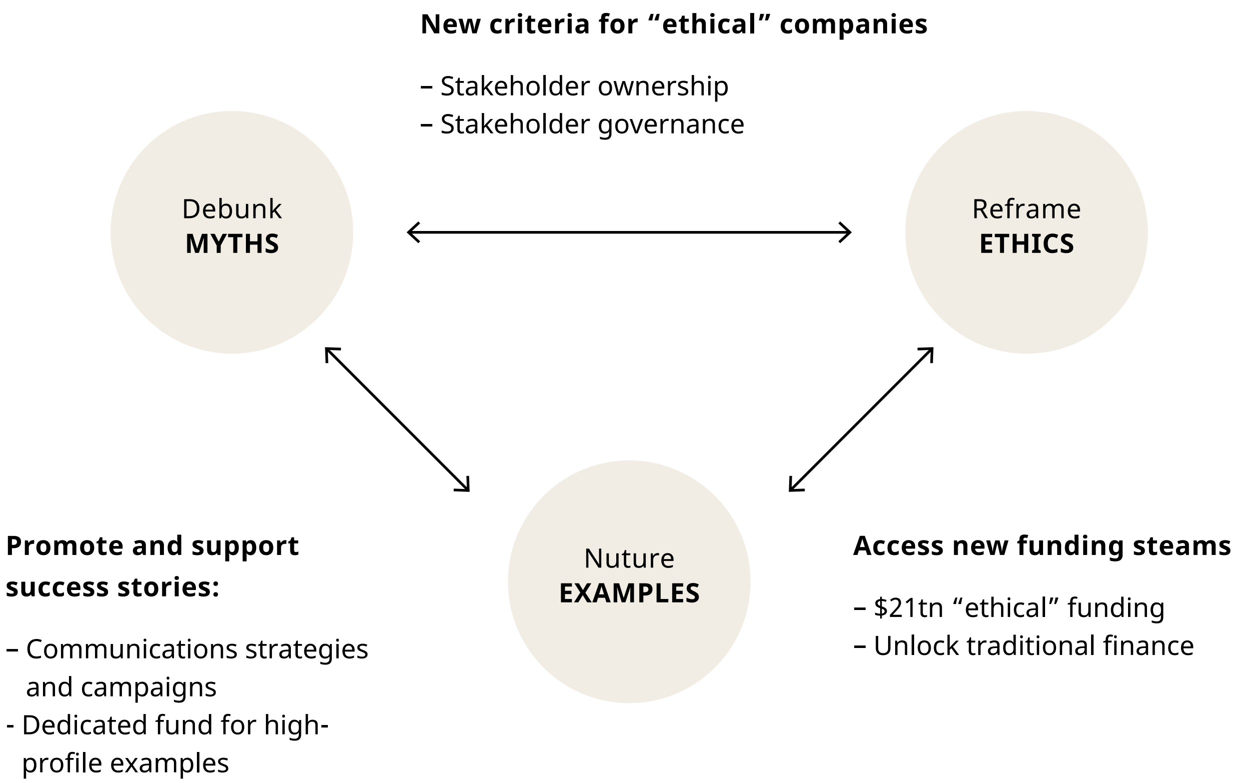


Figure 2:

Strategies for breaking the cycle of corporation-domination with cooperatives.

shaming tactics. Consistent with the analysis in Part Three, ideally these investments should be some form of debt-financing, rather than entailing governance or voting rights. Indeed, outright ownership by investors of profits generated by the labor of workers or through the involvement or impact on communities ought to be seen as inherently "irresponsible", and therefore incompatible with "socially responsible" investing.

- Reward and publicly promote cooperatives. Successful cooperatives should be profiled and highlighted, in order to help break the cycle as identified above. Ideally, this should

be done not by highlighting inherently extractive factors, such as profit margins or market share, but rather staff retention, workplace satisfaction, sustainable growth and wage levels and wealth of workers. This includes enlisting wider cultural influencers, such as journalists, researchers, writers, artists and beyond to study and explore the outcomes.

- Leverage ethical funds to invest in cooperatives. Once a norm of impact investing funds has been obtained, and there are a greater number of positive success stories, this can be used to pressure and persuade much larger funds to invest either in those impact funds or into cooperative loan or conversion funds over the longer-term.

- Shaming self-identified “socially responsible investment” funds that do not invest in cooperatives. In addition to positive advocacy, eventually negative shaming and investigative exposés into the abusive and harmful behavior of companies that major funds deem “ethical” and “responsible” is needed, along with a shaming of funds that actively resist or reject efforts to support cooperatives. Ultimately, this is to be expected, given that such funds will be expected to significantly reduce their returns (as debt financing at sustainable rates ought to deliver significantly lower returns than the 20 times returns on initial investments that can be sought in venture capital or equity finding).

The benefits of such campaigns would have positive ramifications outside the cooperative sector, by highlighting the structural inequalities of our economic system. It is a campaign that ought to be multi-dimensional and intersectional, drawing in advocates from human rights, environmental, racial justice and climate justice movements; it could also operate at grassroots through to policy-levels. While some coordination might be desirable, ultimately such a campaign could occur organically with specific local and regional flavors and focus.

CONCLUSION

Conclusion

Cooperatives hold the potential to significantly address economic inequalities and structural inequities. However, to do so, they will need to overcome the significant barriers to capital, in order to grow—whether vertically or horizontally—sufficiently such that they can exist as viable alternatives to traditional corporate models. While there has been significant innovation over the last decade in terms of the types of debt financing available, there has been only limited increase in the amount of finance available for loans and debt funding for worker cooperatives. Thus, worker cooperatives have remained constrained in their ability to grow. This is a particularly acute challenge for worker or multi-stakeholder cooperatives seeking to use platform models to challenge big tech, given its easy access to capital.

Absent major economic transformative of capitalism or political systems such that cooperatives are the preferred economic entity, such changes will need to result, at least in part, from pressuring existing holders of capital to invest in cooperatives. Putting policy interventions aside (although these ought to be pursued simultaneously), there are two methods for this: a) demonstrating the business case and b) demonstrating the societal case. This paper argues that strategies that seek to demonstrate the societal case are underleveraged relative to the amount of money circulating in “ethical” and “socially responsible” finance.

A critical strategy for overcoming this is to focus on publicly discrediting existing “ethical” corporate structure and investment funds, highlighting the abusive practices of large corporations and the failures of existing social responsible investing to actually do as they claim: to promote societal positive outcomes. In their place, cooperatives ought to be raised up, with campaigns and pressure on the 31 trillion US *dollars* “social responsible” industry to invest in cooperatives. Indeed, if they make just 1 percent of funds available, this will represent more than a thousand times the amount of money available to cooperatives.

None of this will happen easily or quickly. Fundamentally, increasing funding options available to cooperatives to the extent necessary for cooperatives will only happen by dispelling the myths of unbound capitalism, which decades of struggle will attest is no small task.

NOTES

Endnotes

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APPENDICES

Appendices

Appendix A: Sample term sheet for profit-sharing

See the terms set out here.[47]

Appendix B: Sample term sheet for revenue-sharing

See the terms set out here.[48]

Appendix C: Sample term sheet for target-dividend

See the terms set out here.[49]

Appendix D: Sample term sheet for demand-dividend

See the terms set out here.[50]

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